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Report to Congressional Requesters

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DEFENSE INVENTORY

Navy's Procedures for Controlling In-Transit Items Are Not Being Followed

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National Security and
International Affairs Division

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March 31, 1999

The Honorable Richard Durbin
The Honorable Tom Harkin
United States Senate

The Honorable Peter DeFazio
The Honorable Carolyn B. Maloney
House of Representatives

In February 1998, we reported that the Department of Defense (DOD) did not have receipts for about 60 percent of its 21 million shipments to end users in fiscal year 1997.[1] Among the DOD components, the Navy was responsible for almost one-half of DOD's 12.4 million unacknowledged receipts. As agreed with your offices, we reviewed selected aspects of the Navy's management procedures for controlling items in transit. More specifically, we (1) identified the reported value and types of inventory in transit within and between storage and repair activities, vendors, and end users that were unaccounted for (or lost) and (2) assessed the Navy's adherence to procedures for controlling such in-transit inventory.

This report is one in a series addressing defense inventory management as a high-risk area in the federal government because of vulnerabilities to fraud, waste, and abuse.[2] Excess property that is in transit between the military services and disposal offices is the topic of a separate report we will issue later this year.

Results in Brief

The Navy has not effectively controlled its in-transit inventory and places enormous amounts of inventory at risk of undetected theft or misplacement. For fiscal years 1996-98, the Navy reported that it had lost over $3 billion in in-transit inventory, including some classified and sensitive items such as aircraft guided-missile launchers, military night vision devices, and communications equipment. The Navy's Inventory Control Point (NAVICP) at Philadelphia, which manages the largest portion of the Navy's inventory, reported the largest losses—$2.5 billion, or

[1] Department of Defense: In-Transit Inventory (GAO/NSIAD-98-80R, Feb. 27, 1998).

[2] In 1990, we began a special effort to review and report on the federal program areas we identified as high risk because of vulnerabilities to waste, fraud, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Government Affairs and the House Committee on Government Reform, brought a much needed focus on the problems that were costing the government billions of dollars. We identified inventory management as high risk in our 1999, 1997, 1995, and 1992 high-risk reports. A list of related GAO products is at the end of this report.

84 percent of the Navy's in-transit losses. However, our work showed that a few of the items reported as lost by NAVICP Philadelphia had in fact been accounted for in inventory records.

Navy activities involved in issuing and receiving inventory items have not always followed the Navy's control procedures to ensure that in-transit items are accounted for. Specifically,

- Navy units have not always reported to NAVICP Philadelphia that they received requested items.
- Ineffective accounting systems have been used to monitor receipts of items redistributed between storage activities, shipped to and from repair facilities, and shipped from end users.
- NAVICP Philadelphia and its shipping and receiving activities have not adequately investigated unreported receipts of items redistributed between storage activities, shipped to and from repair facilities, and shipped from end users.
- NAVICP Philadelphia has not monitored receipts of items it purchased from commercial sources. As early as 1990, we reported that there were indications of inadequate internal controls over procured assets.
- Naval Supply Systems Command and NAVICP Philadelphia oversight of in-transit inventory has not been adequate. Although Navy officials have initiated actions intended to correct the problems we cited, the Navy has not established any performance measures, milestones, or timetable for reducing the vulnerability of in-transit inventory to theft or loss. Further, the Navy has not identified management of in-transit inventory as a significant weakness in its assessments of internal controls, as provided in the Federal Managers' Financial Integrity Act of 1982.

When considered as a whole, weaknesses in monitoring and controlling its in-transit inventory have undermined the Navy's ability to measure progress toward achieving the goal set out in DOD's Performance Plan for fiscal year 1999, which responded to requirements of the Government Performance and Results Act. For example, in its plan, DOD sets a goal of achieving 90-percent visibility over its inventory by 2000.

To improve controls over the Navy's in-transit inventory, we are recommending that the Secretary of the Navy ensure that (1) receipts of in-transit shipments are adequately accounted for and monitored; (2) records of inventory receipts are routinely updated; (3) in-transit inventory problems are included in assessments related to the Federal Managers' Financial Integrity Act; and (4) performance measures,

milestones, and timetables are established to help monitor progress in reducing Navy inventory's vulnerability to loss.

Background

As of September 30, 1997, the Navy reported that the value of its inventory was $16.8 billion.[3] The Naval Supply Systems Command (NAVSUP) administers the Navy supply system and provides in-transit inventory management policies and procedures. The Command, through its NAVICP,[4] initiates purchases and directs inventory movement for its customers. Until the inventory reaches its intended destination, NAVICP refers to it as in transit. The major categories of in-transit inventory are as follows:

- Warehoused material—material redistributed between storage activities, broken items shipped from Navy consolidation points to a commercial or other military service repair facility, and material returned from a commercial or other military service repair facility or an end user.
- Purchased material—new material shipped from a commercial source to a storage activity.
- End-user material—material ordered from a storage activity or commercial source by a unit that expects to use it.

The Navy is required to use a variety of inventory tracking procedures to monitor shipment and receipt of in-transit items. Although the specific procedures for each major category have some differences, they all have three common control elements. First, the recipient of the material is responsible for notifying the NAVICP once the item has been received. This notification is an internal control designed to account for all in-transit assets. Second, if within 45 days of shipment NAVICP has not been notified that a shipment has arrived, it is required to follow up with the intended recipient. The rationale behind this requirement is that until receipt is confirmed, the exact status of the shipment is uncertain and therefore vulnerable to fraud, waste, and abuse. Third, the Navy is required to oversee in-transit inventory to assess the effectiveness of policies and procedures governing that inventory. Appendix II contains additional

[3]This amount includes three categories of items that are valued differently. Serviceable items are valued at the latest acquisition cost; the value for items requiring repair are reduced by the cost of repair; and excess, obsolete, and unserviceable items—reutilization/disposal inventory—are valued at salvage prices (2.7 percent of latest acquisition cost for fiscal year 1997). However, the standard price (i.e., latest acquisition cost and a surcharge covering the costs to operate the supply system) is used throughout DOD in its logistics systems. Therefore, throughout the remainder of this report, the standard price is the value associated with in-transit inventory.

[4]NAVSUP has one Inventory Control Point that has offices in two cities—Philadelphia and Mechanicsburg, Pennsylvania.

details on the receipt acknowledgment and follow-up procedures for in-transit items.

Implementing inventory controls is a shared responsibility of the NAVICP and shipping and receiving activities, which include Defense Logistics Agency (DLA)[5] and Navy-managed activities, and repair facilities.

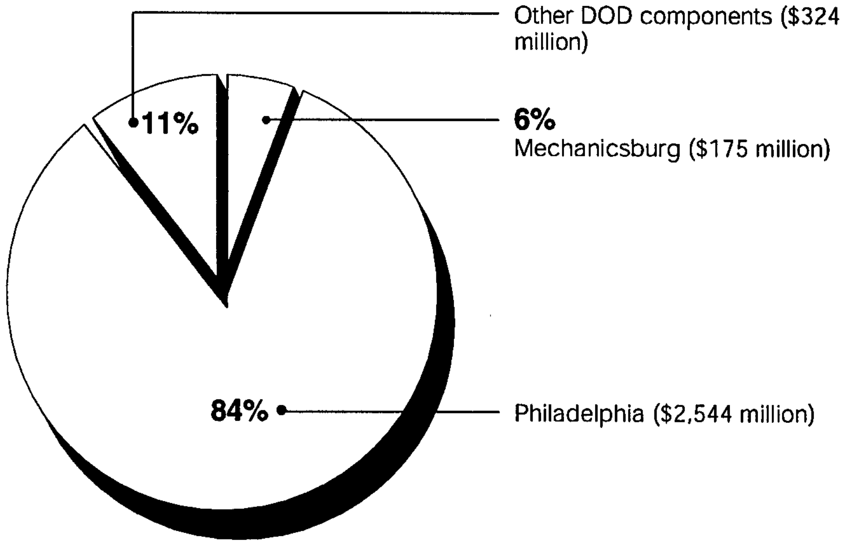
Accountability Is Lost for Substantial Amounts of In-Transit Inventory

The Navy reported that it was unable to account for substantial amounts of in-transit inventory. This inventory is vulnerable to theft or loss and could cause managers to implement inefficient, ineffective decisions and practices regarding purchases. Between October 1995 and September 1998, the Navy reported that it wrote off as lost in-transit inventory valued at over $3 billion. Our analysis of financial reports showed that NAVICP Philadelphia was responsible for about $2.5 billion, or 84 percent, of these losses.[6] Figure 1 summarizes the value of in-transit inventory losses by inventory control point.

[5]The Defense Logistics Agency operates and manages storage activities. It receives, stores, and issues inventory and maintains inventory records.

[6]Between October 1995 and September 1998, NAVICP Philadelphia reported $32.4 billion in warehoused material had been in transit at one time or another during the period.

Figure 1: Reported Value of Navy-Owned In-transit Inventory Losses by Inventory Control Point



Note: Numbers do not add due to rounding.

The Navy's in-transit inventory losses may be greater than the Navy recognizes because of uncertainties about the status of shipments to end users that did not have a corresponding notification of receipt. Figure 1 does not include any unaccounted for shipments to end users. For example, as we reported in February 1998, DOD did not have receipts for about 60 percent of its 21 million shipments to end users in fiscal year 1997. Among the DOD components, the Navy was responsible for over one-third of DOD's 21 million shipments and almost one-half of DOD's 12.4 million unacknowledged receipts (valued at $11.7 billion).

Our review of 30,314 lost warehoused shipments (representing 132,793 items worth $753 million) at NAVICP Philadelphia in fiscal year 1997 showed that over 8,000 shipments contained military technology that needed to be protected.

Classified and sensitive items[7] included aircraft-guided missile launchers, military night vision devices, and communications equipment. Moreover,

[7]Classified items require the highest degree of protection in the interest of national security. Sensitive items, that is, those items that are of high value, highly technical, or hazardous in nature and small arms, ammunition, explosives, and demolition material, require a high degree of protection and control due to statutory requirements or regulations.

some shipments reported as lost included pilferable items such as radio sets and radar transmitters that have a ready resale value or civilian application and are therefore especially subject to theft. Although not categorized by DOD as pilferable, the lost items also included such items as video recorders and generators. Figure 2 summarizes the items lost in transit by security classification and figure 3 shows the items' value.

Figure 2: Our Analysis of the Number of Lost Warehoused Items Managed by NAVICP Philadelphia

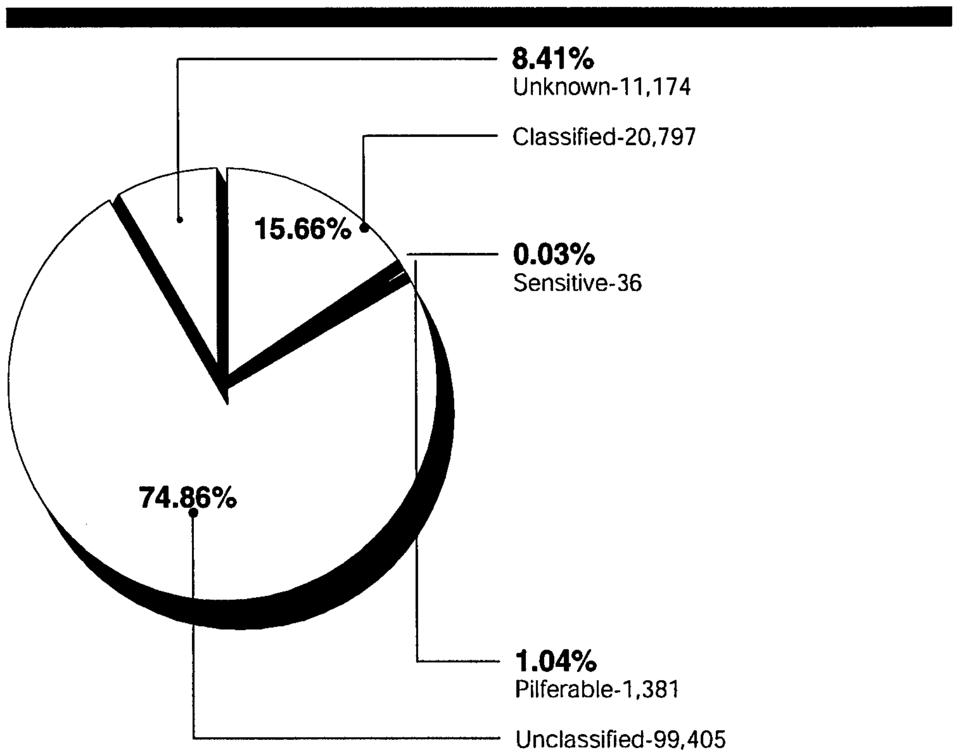
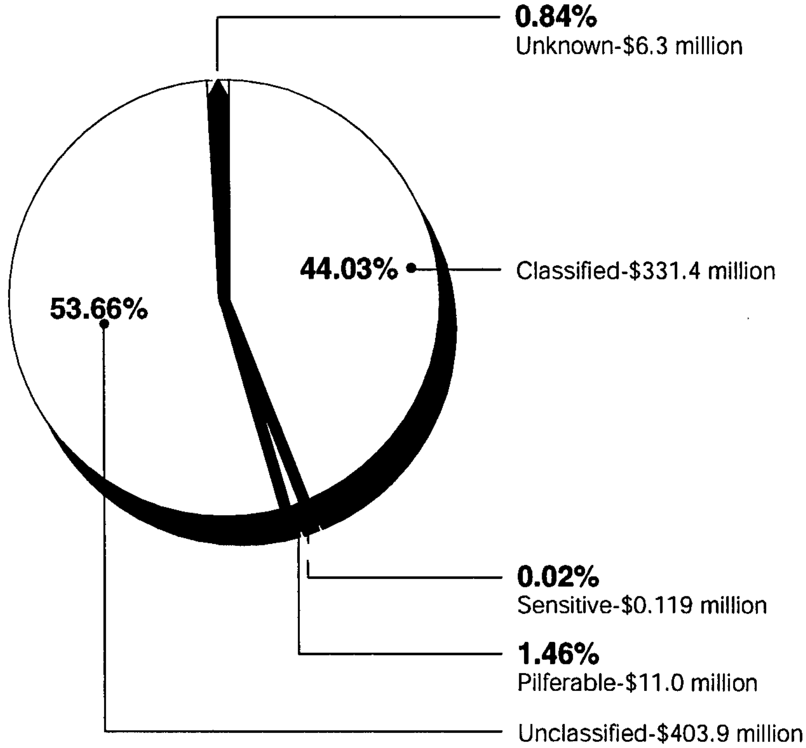


Figure 3: Our Analysis of the Value of Warehoused Material Losses Managed by NAVICP Philadelphia



Note: Numbers do not add due to rounding.

Naval Supply Systems Command and NAVICP Philadelphia officials pointed out that in-transit losses for high-dollar items have declined from $1.2 billion to $600 million over the past 3 fiscal years but acknowledged that in-transit inventory continues to be a primary concern. According to these officials, in some instances the reported in-transit inventory losses might have resulted from accounting adjustments and, as such, were not real losses. They further stated that in most cases, the reported losses occurred because activities involved in the movement, repair, and storage of in-transit items did not (1) notify NAVICP Philadelphia that they shipped or received items as required by Navy regulations or (2) respond to follow-up inquiries made by NAVICP Philadelphia. However, as we note in the following section, our review of lost in-transit sample items revealed that the failure to comply with procedures for controlling in-transit

inventory did not stop with the issuing, shipping, and receiving activities and did not result from accounting adjustments as Navy officials asserted.

Procedures and Systems for Controlling In-Transit Inventory Are Ineffective or Not Followed

As a result of several significant control weaknesses, the Navy's in-transit inventory is highly vulnerable to fraud, waste, and abuse. First, end users have not routinely reported receipt of items to the NAVICP. Second, the integrated accounting and logistics systems that tie the Navy's accounting systems to its in-transit inventory tracking systems have not been effective. Third, NAVICP Philadelphia and its issuing activities, intended recipients, and commercial carriers have not adequately investigated cases in which warehoused material was not acknowledged as received. Fourth, NAVICP Philadelphia has not monitored the receipt of purchased material from commercial sources. Fifth, NAVSUP and NAVICP Philadelphia have not provided adequate oversight and monitoring of in-transit inventory.

End Users' Receipts of Material Were Not Routinely Reported

End users have not routinely reported receipt of items to NAVICP Philadelphia. For a 1-year period ending in May 1998, NAVICP Philadelphia closed the records for over $743 million in shipments that did not have a notification of receipt and had been outstanding for over 90 days. The NAVICP transfers accountability of material when it issues a release order to a DOD storage activity to ship the material and then to customers when they receive the material. End users are required by DOD policy to record receipts of material and notify the appropriate inventory control point within 5 calendar days (either electronically or by mail).

We judgmentally selected for review 92 reported end-user shipments (valued at $5.2 million) whose receipt, according to NAVICP Philadelphia records, had not been acknowledged. We sought to determine whether those shipments had in fact been received and reported to NAVICP Philadelphia. According to NAVICP Philadelphia officials, 51 of the 92 shipments (valued at over $566,000) were to storage activities and had been incorrectly shown as end-user shipments. Thus, the records of the shipments should not have been closed by the NAVICP Philadelphia automated tracking system for end-user receipts. We then reviewed the status of these 51 shipments in the warehoused material receipt tracking system. NAVICP Philadelphia and the intended recipient were unable to provide evidence that four shipments had been delivered or received. The remaining 47 shipments had been received.

Of the remaining 41 shipments (valued at $4.7 million), we determined that 28 (valued at $3.3 million) had in fact been received and accounted for, but the receipt acknowledgments had not been sent to NAVICP Philadelphia. According to one Defense Automated Addressing System (DAAS)[8] Office official, the end users' receipt acknowledgment codes were obsolete. Consequently, DAAS did not forward the acknowledgments to NAVICP Philadelphia. When we informed end-user officials that their acknowledgment codes were obsolete, they said that the Navy had not yet changed its reporting systems and procedures to conform with DOD's changes in the codes. Our review also showed other shortcomings in the execution of in-transit control policies and procedures for the remaining 13 shipments. For example:

- One shipment valued at $606,330 was assumed by NAVICP Philadelphia to have been received by the end user but was never shipped by the depot.
- Twelve shipments valued at $737,986 had been received by the end user but were not reported to NAVICP Philadelphia. End-user officials said that their automated logistics system is not designed to acknowledge material receipt. However, DOD policy states that if the reporting activity cannot transmit receipt electronically, it should prepare a manual material receipt acknowledgment and mail the form directly to the inventory control point.

Integrated Accounting and Logistics Systems Were Not Always Effective

Because of poorly integrated accounting and logistics systems, the Navy may have written off as lost millions of dollars of warehoused material shipments that had actually been received and accounted for by NAVICP Philadelphia and in DAAS historical records. Navy policy for following up on in-transit material states that the NAVICP should search its internal files for delinquent receipts of warehoused material shipments. Delinquent shipments, according to Navy policy, should be written off as inventory losses if their receipts remain unconfirmed after 6 months or 11 months, depending on their value. According to Navy policy, shipments of consumable items, depot-level reparable items, and appropriated purchases[9] valued at less than $2,500, $15,000, and $20,000, respectively, should be written off as inventory losses if their receipts remain unconfirmed after 6 months. All other shipments require external

[8]The DAAS Office is the single most comprehensive source in DOD for identifying the movement of in-transit material. It receives a vast amount of shipping and receiving data and passes this information to the appropriate inventory control point.

[9]Consumable items are individual parts or assemblies that are disposed of when replaced. Depot-level reparable items are components or assemblies that are returned to the supply system to be repaired when replaced. Appropriated purchases are centrally purchased items that customers receive without charge from their respective supply systems.

follow-up and should be written off as lost if their receipts remain unconfirmed after 11 months.

At NAVICP Philadelphia, 15 (16 percent) of the 94 warehoused shipments that we sampled were written off as lost despite the fact that their receipts were recorded in NAVICP Philadelphia's internal files and DAAS historical records 6 months to 1 year in advance of the date they were written off. These discrepancies reduce the reliability of inventory financial reports, which thus obscure true inventory losses, such as those resulting from theft or loss, and misstate the number of items on hand.

We informed NAVICP Philadelphia officials that their internal and DAAS history files contained receipts for 15 warehoused shipments that were written off as lost. They said that in 11 cases, they had not accurately identified these receipts because the Navy's general ledger system, which ties its accounting systems to its logistics and other key management systems and is used to identify the receipt of shipments, did not update both accounting and logistics records with the in-transit inventory receipts. In the other four cases, the receiving activities did not correctly enter receipt data into the logistics system; thus, the NAVICP's integrated systems showed that the items were not received. NAVSUP officials said that until the planned resystemization of its databases is complete, NAVICP Philadelphia would need to rely on the Navy's general ledger system to identify the receipt of shipments. Our prior reports have pointed out deficiencies in DOD's existing accounting and related systems, including its logistics systems.[10]

NAVICP's External Follow-Up/Resolution of Warehoused Material Was Not Adequate

Although Navy policy requires external follow-up of unconfirmed receipts of warehoused material over a certain dollar threshold, NAVICP Philadelphia has not adequately followed up or resolved such receipts. According to Navy policy, the NAVICP should first seek proof of shipment from the issuing activity on shipments of consumable items, depot-level reparable items, and appropriated purchases valued at more than $2,500, $15,000, and $20,000, respectively, within 45 days from the date the material was issued. After obtaining that information, the NAVICP should seek proof of delivery from the shipping carrier. Navy policy, however, does not set a specific time limit for replies from issuing activities, shipping carriers, and intended recipients.

[10] High-Risk Series: Defense Financial Management (GAO/HR-97-3, Feb. 1997) and Inventory Management: Vulnerability of Sensitive Defense Material to Theft (GAO/NSIAD-97-175, Sept. 19, 1997).

We sampled 17 warehoused shipments (valued at $2.3 million) that required external follow-up. For these shipments, NAVICP Philadelphia officials explained that commercial carriers, storage activities, and repair contractors did not respond to their follow-up requests and the shipments were later written off as lost. However, our review showed that 2 of the 17 shipments (valued at $215,760) were erroneously written off as lost but in reality had been acknowledged as received and accounted for in NAVICP inventory records. For the remaining 15 shipments (valued at $2,085,200), NAVICP did not follow up when receipts were not returned. Specifically, in 6 of the 15 shipments (valued at $910,600) NAVICP Philadelphia did not adequately follow up for proof of shipment, delivery, or receipt with the appropriate activities. For three other shipments (valued at $479,040), the carriers did not respond to NAVICP's requests for proof of delivery, and NAVICP did not initiate claims against the carriers. For five shipments (valued at $647,230), the storage or repair activity did not respond to NAVICP's requests for proof of receipt. NAVICP Philadelphia officials could not explain what happened to the remaining shipment (valued at $48,330) and could not provide documentation that they had followed up on the shipment to account for its loss.

The following two examples illustrate how the inadequate follow-up and resolution of overdue shipments results in reported in-transit losses of material.

In September 1996, the Defense Distribution Depot in Norfolk, Virginia, issued 24 generators (valued at $212,640) to a commercial carrier for shipment to a commercial repair contractor. According to NAVICP Philadelphia officials, the repair contractor did not acknowledge receipt of the material. Over 90 days later, in December 1996, the NAVICP requested proof of issuance from the Norfolk depot, which the depot provided in January 1997. In February 1997, the NAVICP sought proof of delivery from the carrier, which did not confirm delivery. NAVICP officials said they did not initiate a claim against the carrier. The material was later written off as an in-transit loss.

In October 1995, the Norfolk depot reportedly issued 29 aircraft guided-missile launchers (valued at over $181,830) to the Fleet and Industrial Supply Center in San Diego, California. According to NAVICP Philadelphia officials, the Center did not acknowledge receiving the equipment. In February 1996, NAVICP sought proof of issuance from the Norfolk depot, which it provided in April 1996. NAVICP Philadelphia officials

said that they then unsuccessfully sought proof of receipt from the Center from April to October 1996, when the items were written off as lost.

Purchased Material Receipts Were Not Monitored

NAVICP Philadelphia has not monitored the receipt of purchased material from commercial sources. Under Navy policy, NAVICP must follow up with the appropriate depot on receipts for purchased material 45 days from the date of the shipment, and the depot must respond to NAVICP on the status of the shipments. However, NAVICP Philadelphia officials told us that they neither monitor shipments nor follow up on delinquent receipts. These officials said they were unaware that NAVICP was required to initiate follow-up on delinquent receipts. During our review, NAVICP Philadelphia reported that in-transit purchased material totaled over $75 million, of which $4.8 million in material had been in transit for over 1 year.

We judgmentally selected and reviewed records for 28 shipments (valued at about $1 million) with outstanding purchased material balances over 1 year old and found the following:

- Eight shipments (valued at $172,099) had been sent from commercial vendors to end users over 1 year earlier, but NAVICP Philadelphia officials had not attempted to follow up on delinquent receipt notifications to determine whether the shipments had been received.
- NAVICP Philadelphia's automated records indicated that six shipments of purchased material (valued at $343,679) were in transit, but in fact there were no such shipments. Instead, expenses of $343,679 had been incurred to terminate the six contracts erroneously processed as outstanding purchased material. According to Navy officials, the Defense Finance Accounting Service disbursement system does not distinguish between material and termination settlement payments, both of which accrue purchased material.
- One shipment (valued at $26,566) reflected outstanding purchased material in NAVICP Philadelphia's automated financial records, but the amount was in fact for internally generated progress payment expenditure corrections.
- NAVICP Philadelphia's automated records indicated that two shipments of purchased material (valued at $38,750) were in transit, but in actuality $38,750 was the difference between the estimated and final contract cost of the two shipments.
- Eleven shipments (valued at $438,395) were received, but one of NAVICP Philadelphia's automated inventory records was not updated to reflect the status of these shipments. According to NAVICP Philadelphia officials,

receipts for the shipments were processed in their automated contract status file but were not reflected in the procurement obligation status file. Consequently, the established procurement remained on the NAVICP's file as outstanding purchased material. No effort had been made to reconcile these 11 inconsistencies.

In May 1990, we reported discrepancies between NAVICP Philadelphia's purchased material shipment records and receipt records, a condition that may adversely affect procurement decisions.[11] We further reported that these discrepancies indicated inadequate internal controls over procured assets and did not provide NAVICP Philadelphia with reasonable assurance that its procurement system was adequately protected from waste, fraud, and abuse. In addition, the NAVICP Philadelphia, in its fiscal years 1995-98 management control reviews, cited ongoing problems with the systems used to track purchased material.

In-Transit Inventory Receipt and Follow-Up Efforts Were Not Always Monitored

NAVSUP and NAVICP Philadelphia have not always monitored warehoused material receipt and follow-up efforts as required by Navy policy. The policy requires periodic reviews of in-transit inventory losses to highlight breakdowns in the physical distribution process and assist the NAVICP in monitoring its performance. These reviews are also designed to give NAVSUP a means of assessing the effectiveness of its policies and procedures for governing in-transit inventory. Although NAVICP Philadelphia compiles summary data on in-transit inventory losses, its officials responsible for inventory accuracy acknowledged that they do not compile data that identifies the predominant causes, sources, and magnitude of in-transit inventory losses, even though the compilation of such information is required by Navy policy. The lack of this information impede's the Navy's ability to determine which activities are responsible for lost or misplaced items. NAVSUP officials acknowledged that they had not actively monitored in-transit inventory receipt and follow-up efforts but had recently begun to review both systems and processes to correct weaknesses.

The Federal Managers' Financial Integrity Act of 1982 requires that agency heads provide an annual statement to the President and Congress on whether their agency's internal control systems comply with the internal control objectives of the act. If the agency head decides that agency systems do not comply, a report identifying material weaknesses involved

[11] Navy Supply: Procurement Leadtime Forecasting Needs Improvement (GAO/NSIAD-90-78, May 18, 1990).

and the plans and schedules for correcting the weaknesses must be submitted with the statement. The statement is also to include a report on whether the agency's accounting system conforms to the Comptroller General's standards. However, the Navy did not identify significant weaknesses in internal controls over NAVICP's in-transit inventory in its Financial Integrity Act statements over the past 3 years, despite the fact that it had written off as lost inventory valued at more than $3 billion. Moreover, the Navy has not established any performance measures, milestones, or timetables for reducing the risk of its in-transit inventory to undetected theft or misplacement.

Internal Control Weaknesses Undermine Navy's Ability to Meet Results Act Requirements

The weaknesses in the Navy's internal controls over in-transit inventory undermine its ability to measure its progress toward achieving the goals set out in DOD's recent Performance Plan, covering fiscal year 1999, prepared in response to the requirements of the Government Performance and Results Act. DOD's plan calls for improving asset visibility in such areas as in-transit assets and sets up the goal to achieve 90-percent visibility over material by 2000. Current Navy internal controls over in-transit inventory do not provide a reliable means to establish visibility.[12]

Our review of items that the Navy had reported as being lost in transit indicated that at least some had in fact been acknowledged as received. In other cases, Navy officials wrote off in-transit inventory items because they did not know whether the items had been stolen or otherwise lost. In other words, they did not have adequate visibility over them. The lack of adequate internal controls undermines the Navy's ability to do its part in helping DOD achieve a 90-percent visibility rate over inventories by 2000 and reduce inventories by 2003.[13] The lack of controls may also limit the ability of DOD and Navy officials to effectively manage the movement of material and to make sound decisions about redistributing items rather than buying new items or optimizing the positioning of stock.

DOD is also required by the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 to develop a comprehensive plan to ensure visibility over in-transit secondary items. For secondary items, the law requires that DOD's plan address such issues as the

[12]Asset visibility is intended to provide defense personnel with timely and accurate information on the location, movement, status, and identity of units, personnel, equipment, and supplies across all DOD components.

[13]In its plan, DOD also sets an indicator of reducing secondary item inventories to $48 billion by 2003.

- vulnerability of in-transit items to loss through fraud, waste, and abuse;
- loss of oversight of in-transit items, including items transported by commercial carriers; and
- loss of accountability over in-transit items due to either a delay of delivery of the items or a lack of notification of the delivery.

The act called for DOD to submit its plan to Congress by March 1, 1999. However, on March 4, 1999, DOD informed Congress that additional time was necessary to prepare the plan due to, among other things, the broad scope of the requirement and the need to thoroughly study our findings on in-transit inventory. DOD stated that it intended to submit a comprehensive plan to Congress by September 1, 1999.

Conclusions

The Navy has not effectively controlled its in-transit inventory, leaving significant amounts of inventory unaccounted for. Significant weaknesses exist at all levels of the Navy's in-transit inventory management structure. These weaknesses lead to potential theft or undetected losses of items and demonstrate inefficient and ineffective logistics management practices such as potentially shipping or buying unnecessary inventory. These weaknesses and the problems they create are primarily a result of the failure of the Navy to follow its own policies and procedures regarding controls of in-transit inventory. Further, significant problems exist in data reporting systems.

Recommendations

In conjunction with developing a statutorily required, comprehensive plan to address visibility over in-transit inventory, DOD should take a number of immediate steps to improve controls over the Navy's in-transit inventory. Specifically, we recommend that the Secretary of Defense direct the Secretary of the Navy to do the following:

- Comply with existing DOD and Navy procedures regarding material receipt acknowledgment of in-transit shipments and reemphasize follow-up procedures on unconfirmed warehoused and purchased material receipts.
- Modify the Navy's integrated accounting and logistics systems so that they routinely update both financial and inventory records when in-transit inventory items are received. Until the systems are operational, NAVICP Philadelphia should establish routine reconciliation procedures for their supply and financial records to ensure oversight and control over in-transit inventory items.

- Specifically target in-transit inventory problems as an issue for review in Federal Managers' Financial Integrity Act assessments.
- Establish performance measures, milestones, and timetables to help monitor the progress being made to reduce the vulnerability of in-transit inventory to undetected loss or misplacement.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD agreed with all of our recommendations and stated that the Navy had taken immediate steps to improve in-transit inventory. The Commander, Naval Supply Systems Command, has chartered an Integrated Process Team to review current systems, policies, and processes to investigate material receipt acknowledgment problems and proposed short-term solutions. The Commander has also chartered a team to review in-transit practices of the other services and of commercial activities in order to reengineer the in-transit process. The Naval Inventory Control Point will include in-transit inventory accounting as part of its fiscal year 1999 management control evaluation of internal controls and report material weaknesses to NAVSUP by August 1, 1999. DOD further stated that the Commander, Naval Supply Systems Command, will establish performance measures and a plan of action and milestones to monitor progress being made to reduce the loss or misplacement of shipments.

Although DOD agreed with our recommendations, it stated that initial research of the $3 billion in Navy inventory written off as lost supports its belief that most of the material was actually received. A DOD official later said that DOD's belief was based on its review of 410 lost warehoused material shipments at NAVICP Philadelphia in fiscal year 1997. According to the official, DOD found that 327 (80 percent) of the 410 shipments had been written off as lost even though they had been received.[14] However, our review at NAVICP Philadelphia indicated a different relationship between shipments later accounted for and those actually lost. Our review showed that 15 (16 percent) of the 94 warehoused shipments we sampled were written off as lost despite the fact that their receipts were recorded and that the Navy, after further investigation, could not account for the whereabouts of the remaining 79 shipments.

Although some of the items reported as lost may actually be in the inventory, DOD does not have an adequate system for determining that on an item-by-item basis. Therefore, we continue to believe a significant

[14]No documentary evidence was available for us to validate this information. We asked the responsible NAVSUP official for information about these 410 shipments and were told that this information was based primarily on telephone calls and e-mail messages by the issuing activities to intended recipients.

number of items are vulnerable to undetected theft or loss. Moreover, until this situation is resolved, these discrepancies reduce the reliability of DOD inventory financial reports, thus obscuring true inventory losses and misstating the number of items on hand.

We believe that the Navy's planned and ongoing initiatives to address its in-transit inventory deficiencies are a step in the right direction. However, in conjunction with the steps taken to improve controls over the Navy's in-transit inventory, DOD needs to develop its plan for in-transit inventory and bring it to fruition. DOD has recently indicated that it will take an additional 6 months to develop the statutorily required, comprehensive plan for its in-transit inventory. Because the act calls for us to review the DOD plan and implementation, we will continue to monitor DOD's efforts to develop its overall plan and be in a position to assess its implementation.

Appendix I contains the scope and methodology for this report, and appendix II contains additional details on Navy procedures for acknowledging and following up on receipts of in-transit inventory. DOD's written comments on this report are reprinted in their entirety in appendix III.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to Senator Daniel K. Inouye, Senator Joseph I. Lieberman, Senator Carl Levin, Senator Ted Stevens, Senator Fred Thompson, and Senator John Warner and to Representative Rod R. Blagojevich, Representative Dan Burton, Representative Jerry Lewis, Representative John P. Murtha, Representative Christopher Shays, Representative Ike Skelton, Representative Floyd Spence, and Representative Henry A. Waxman in their capacities as Chair or Ranking Minority Member, Senate and House Committees and Subcommittees. We are also sending copies of this report to The Honorable William S. Cohen, Secretary of Defense; The Honorable Richard Danzig, Secretary of the Navy; Lieutenant General Henry T. Glisson, Director, DLA; and The Honorable Jacob J. Lew, Director, Office of Management and Budget. Copies will also be made available to others upon request.

Please contact me at (202) 512-8412 if you have any questions. The major contributors to this report are listed in appendix IV.

David R. Warren, Director
Defense Management Issues

Contents

Abbreviations

DAAS	Defense Automated Addressing System
DLA	Defense Logistics Agency
DOD	Department of Defense
GAO	General Accounting Office
NAVICP	Naval Inventory Control Point
NAVSUP	Naval Supply Systems Command

Scope and Methodology

Our objectives for this report were to (1) identify the reported value and types of inventory in transit within and between storage and repair activities, vendors, and end users that were unaccounted for (or lost) and (2) assess the Navy's adherence to procedures for controlling such in-transit inventory.

To assess the Navy's procedures for controlling in-transit inventory and identify the reported types and amounts of in-transit items that were not accounted for, we took the following steps:

- We reviewed policies and procedures and obtained other relevant documentation related to in-transit inventory from officials at the Defense Logistics Management Standards Office, McLean, Virginia; the Defense Automated Addressing System Office, Dayton, Ohio; and the Naval Supply Systems Command (NAVSUP), Mechanicsburg, Pennsylvania.
- We obtained financial reports of in-transit losses between October 1995 and September 1998 at NAVSUP. Using the financial reports, we identified the Naval Inventory Control Point (NAVICP) Philadelphia as the Navy's inventory control activity with the highest reported dollar value of in-transit inventory losses. At NAVICP Philadelphia, we obtained computerized inventory and financial records of in-transit losses between October 1996 and September 1997, the most current and complete in-transit information available. Using the data, we judgmentally selected and reviewed 214 shipments of warehoused, purchased, and end-user material, valued at $9 million, that were reported as lost or not received. We did not independently verify the overall accuracy of NAVICP Philadelphia's databases from which we obtained data but used them as a starting point for selecting shipments that we then tracked back to records and documents on individual transactions.
- For each sample shipment, we reviewed available computer-generated shipment and receipt data, analyzed inventory records, and held discussions at the NAVICP Philadelphia, Pennsylvania; the Defense Distribution Depot, Fleet and Industrial Supply Center, Norfolk Naval Air Station, Norfolk, Virginia; and Oceana Naval Air Station, Virginia Beach, Virginia. To learn whether issues associated with overdue shipments were adequately resolved, we reviewed Department of Defense, Navy, and NAVICP Philadelphia implementing guidance. Such information provided the basis for conclusions regarding the controls over in-transit inventory. To determine whether the Navy had emphasized in-transit inventory as part of its assessment of internal controls, we reviewed assessments from NAVICP Philadelphia for fiscal years 1995-97 and Navy Headquarters for fiscal years 1995-97.

We performed our review between February 1998 and January 1999 in accordance with generally accepted government auditing standards.

Additional Details on In-Transit Receipt Acknowledgment and Follow-Up Procedures

Figure II.1 shows the procedures the Navy is to follow to acknowledge receipts and to follow up on delinquent receipts for shipments of material to end users, figure II.2 shows these procedures for shipments of warehoused material, and figure II.3 shows the procedures for shipments of purchased material.

Figure II.1: End-User Material Receipt Acknowledgment and Follow-Up Procedures

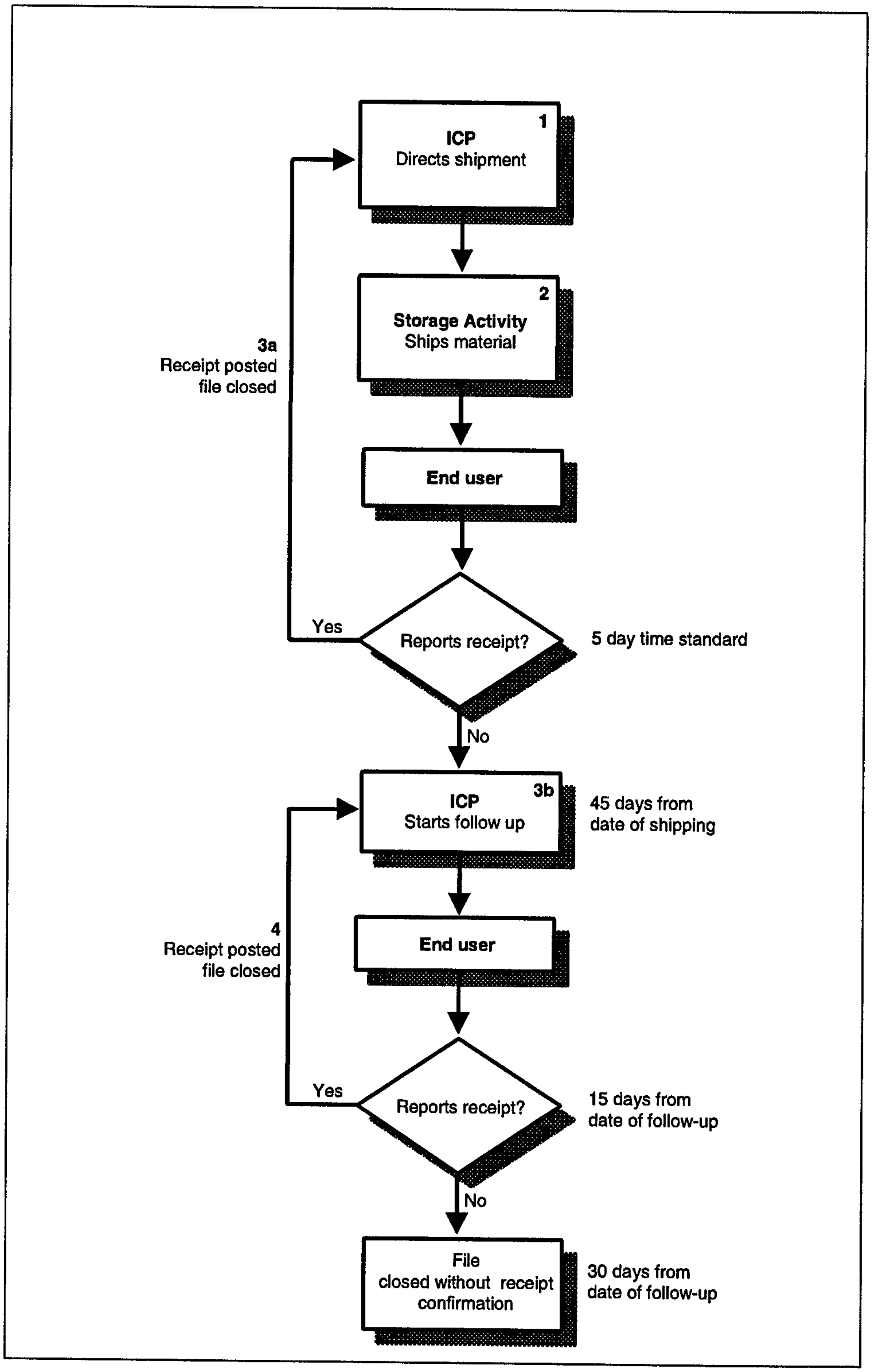


Figure II.2: Warehoused Material Receipt Acknowledgment and Follow-Up Procedures

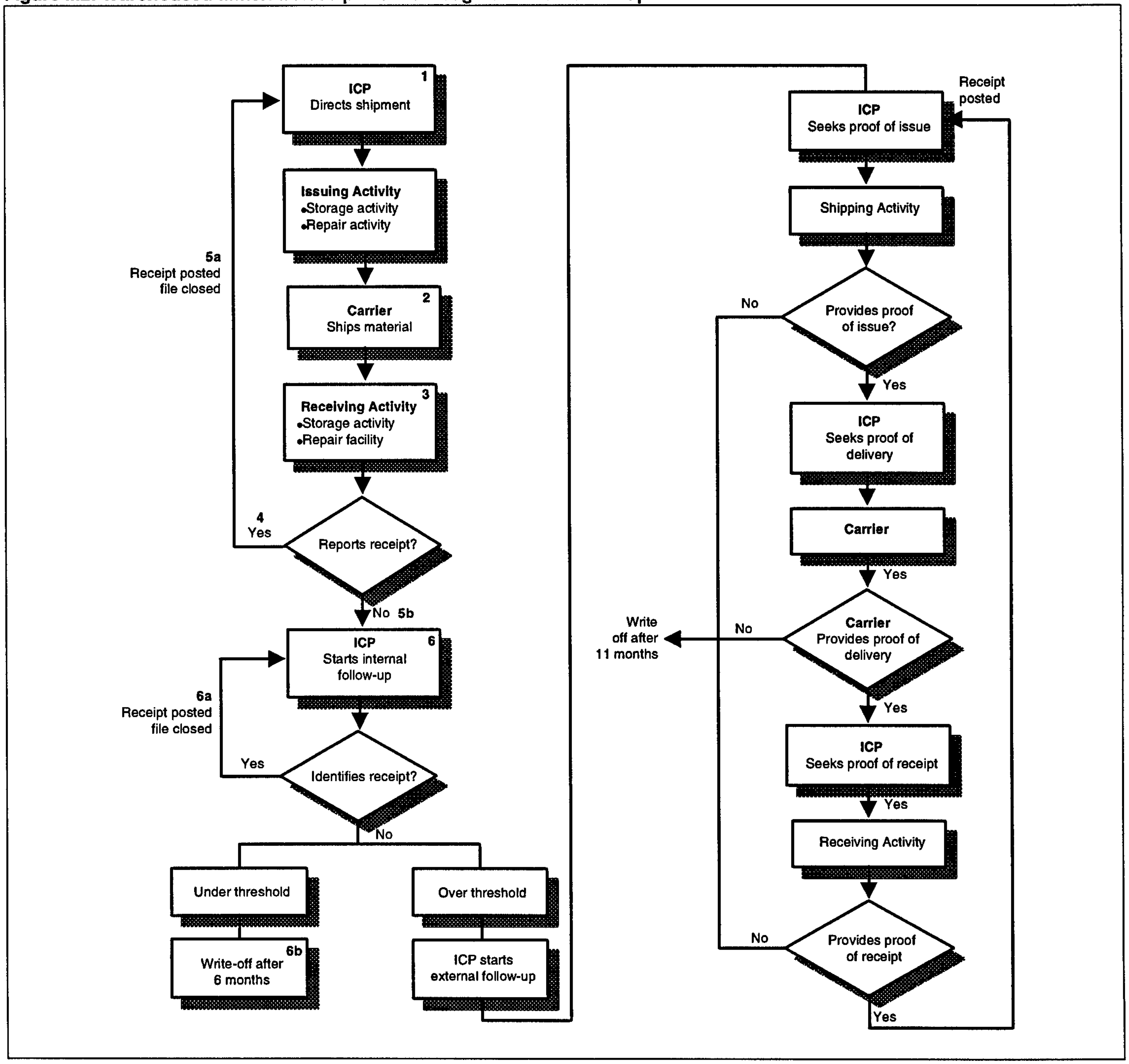
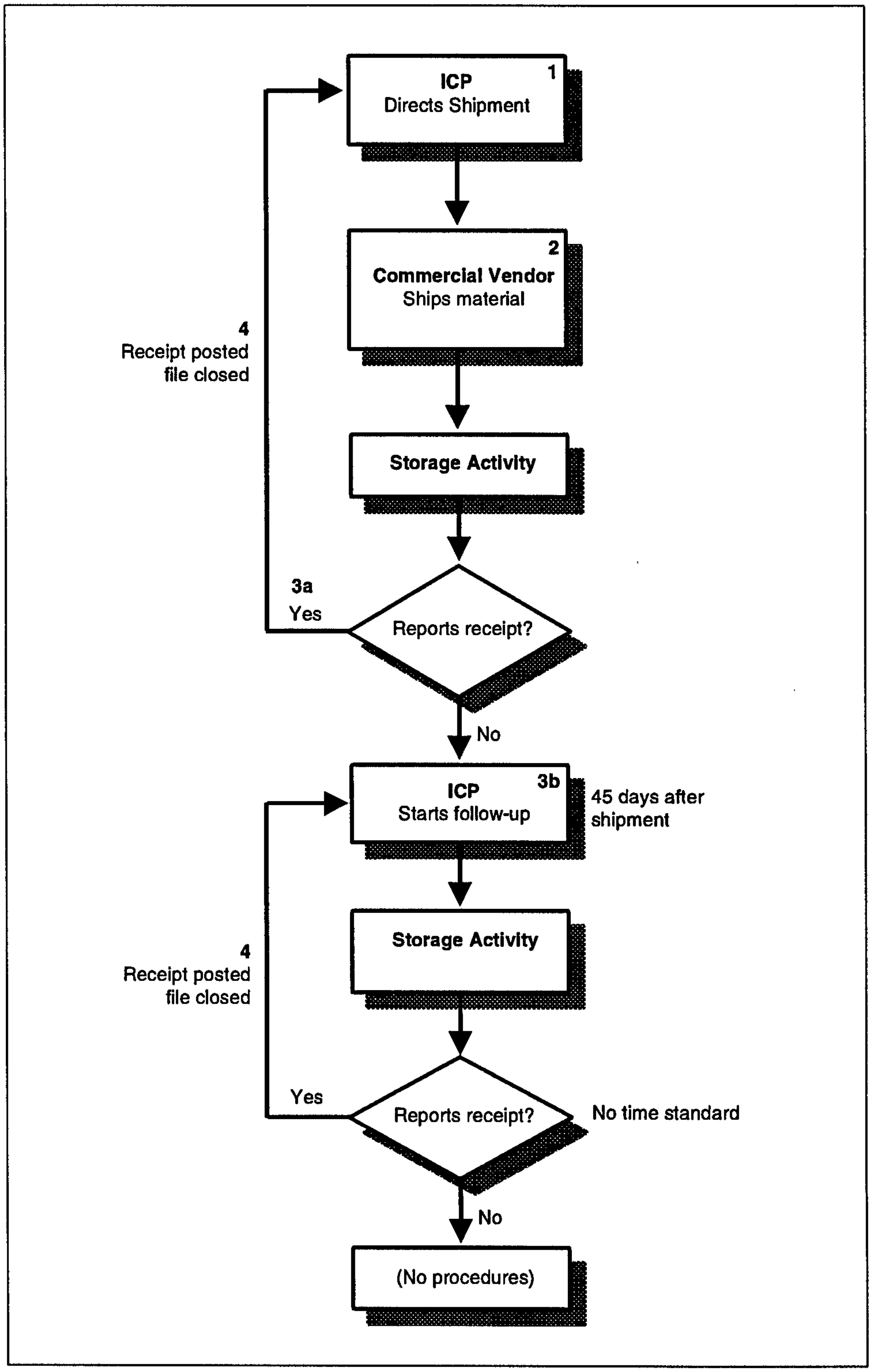


Figure II.3: Purchased Material Receipt Acknowledgment and Follow-Up Procedures



Comments From the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION AND TECHNOLOGY

(L/MDM)

MAR 15 1999

Mr. David Warren
Director, Defense Management Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DEFENSE INVENTORY: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed," Dated February 4, 1999 (GAO Code 709322/OSD Case 1746).

The Department concurs with the recommendations in the draft report. The U.S. Navy has taken immediate steps to improve in-transit inventory, to include adding "In-Transit Accounting" as an assessable unit for Management Control Certification and chartering a U.S. Navy IPT to look specifically at current systems, policies and processes. Initial research of the reported $3 billion of Navy inventory written off as lost supports the belief that most of the materiel was actually received on inventory records, but not reflected accurately in the associated financial accounting process. Measures are already underway to address this situation. These and other measures will be incorporated into the congressionally-mandated, DoD-wide comprehensive plan for in-transit inventory.

The Department's detailed comments to the recommendations are enclosed. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

for Roger W. Kallock
Deputy Under Secretary
of Defense (Logistics)

Enclosure

GAO DRAFT REPORT - DATED FEBRUARY 4, 1999
(GAO CODE 709322) OSD CASE 1746

"DEFENSE INVENTORY: NAVY'S PROCEDURES FOR CONTROLLING IN-TRANSIT ITEMS ARE NOT BEING FOLLOWED"

DEPARTMENT OF DEFENSE COMMENTS TO THE RECOMMENDATIONS

RECOMMENDATION 1: GAO recommended the Secretary of Defense direct the Secretary of Navy to comply with existing DOD and Navy procedures regarding material receipt acknowledgement of in-transit shipments and reemphasize follow-up procedures on unconfirmed warehouse and purchased material receipts.

DOD RESPONSE: Concur. The Commander, Naval Supply Systems Command (NAVSUP), has already communicated the importance of the proper and timely posting of receipts, as well as prompt and accurate responses to follow-up requests, to supply activities through the NAVSUP Monthly update. Additionally, he has chartered an Integrated Process Team (IPT) to look at the current systems, policies, and processes to investigate material receipt acknowledgement problems and proposed short-term solutions. Finally, the long-term solution is to re-engineer the entire in-transit process to include automation, elimination of errors, metrics to monitor the process, and incorporation of business best practices.

RECOMMENDATION 2: GAO recommended the Secretary of Defense direct the Secretary of Navy to modify Navy's integrated accounting and logistics systems to routinely update both financial and inventory records when in-transit inventory items are received. Until the systems are operational, NAVICP Philadelphia should establish routine reconciliation procedures for their supply and financial records to ensure oversight and control over in-transit inventory items.

DOD RESPONSE: Concur. The Commander, Naval Supply Systems Command, has chartered a team to review in-transit practices in the other services as well as commercial activities in order to re-engineer the in-transit process. The re-engineering will use a two pronged approach that addresses reconciliation of accounting and inventory systems, and improves the in-transit visibility process. Specifically, they will reengineer the in-transit visibility process, incorporating both logistics and financial accounting issues into a long-term solution designed to reduce errors/exceptions, and closeout logistics/accounting in-transit records with minimal manual workload. Alternatives will consider IPT baseline assessments, interim changes and best alternative scenarios to solve in-transit problems. Additionally, they will institute both program and transportation solutions. Incorporation of threshold and item characteristics (e.g., classified, pilferable, dollar value) into in-transit solutions will be addressed in a Reengineered Concept of

Operations. Business Case Analysis will validate the reengineered process, followed by implementation of a reengineered system.

In the interim, the NAVSUP sponsored IPT has identified several initiatives designed to provide temporary improvements in the manual reconciliation process until automated programming changes can be made. These improvements are focused on resolving unmatched situations earlier, thereby reducing the number of Stock In-Transit Report of Discrepancy (SITRODs) produced. Solutions identified by the IPT which do not require system programming will be in place no later than 31 March 1999.

RECOMMENDATION 3: GAO recommended the Secretary of Defense direct the Secretary of Navy to specifically target in-transit inventory problems as an issue for review in the Federal Managers' Financial Integrity Act assessments.

DOD RESPONSE: Concur. NAVICP will add an assessable unit for "In-transit Accounting" in their inventory of assessable units. Definition is as follows: In-transit Accounting: Encompasses all procedures associated with Stock-in-Transit and Other Supply Officer Transfers. It does not include end user material sold out of the Navy Working Capital Fund (NWCF) since the Navy does not treat material being shipped to an end user as inventory from an accounting perspective. Although the material is physically moving from one location to another, Navy accounting practices are to post a sale at the time of material issue--there is no posting to an in-transit inventory account.
The purpose of the assessment is to ensure that all required actions (research, follow-ups, and adjustments) are performed so NAVICP's in-transit accounts reflect the actual value of stock-in-transit.

NAVICP will conduct a Management Control Evaluation by July 1999. Material weaknesses discovered will be disclosed in the Management Control Certification Statement. The annual Management Control Certification Statement for FY 1999 is due to NAVSUP on 1 August 1999.

RECOMMENDATION 4: GAO recommended the Secretary of Defense direct the Secretary of Navy to establish performance measures, milestones, and timetables to help monitor progress being made to reduce the vulnerability of inventory in-transit to undetected loss or misplacement.

DOD RESPONSE: Concur. The Commander, Naval Supply Systems Command, is reviewing the current management data to ensure the appropriate focus on reducing loss or misplacement of shipments. Current metrics include the dollar value of unmatched Stock in Transit and total dollar value of Material in Transit. Future metrics may include number, age, and dollar value of SITROD backlogs at each activity, and dollar write-offs by activity each month. Upon establishing the metrics, goals will be determined. These metrics will be briefed monthly and/or

as required at the NAVSUP Corporate Information Board to ensure progress is being made in reducing the dollar value of losses and write-offs. A Plan of Action and Milestones is being developed to monitor process improvements.

Major Contributors to This Report

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Related GAO Products

Performance and Accountability Series: Major Management Challenges and Program Risks—Department of Defense (GAO/OCG-99-4, Jan. 1999).

Department of Defense: Financial Audits Highlight Continuing Challenges to Correct Serious Financial Management Problems (GAO/T-AIMD/NSIAD-98-158, Apr. 16, 1998).

Department of Defense: In-Transit Inventory (GAO/NSIAD-98-80R, Feb. 27, 1998).

Inventory Management: Vulnerability of Sensitive Defense Material to Theft (GAO/NSIAD-97-175, Sept. 19, 1997).

High-Risk Series: Defense Inventory Management (GAO/HR-97-5, Feb. 1997).

High-Risk Series: Defense Financial Management (GAO/HR-97-3, Feb. 1997).

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